370

Commerce and Housing Credit

Budget function 370 covers programs administered by the Department of Commerce, the Federal Housing Administration, and the Small Business Administration, among others. They include programs to regulate and promote commerce and provide housing credit and deposit insurance. Also included in this category are outlays for loans and other aid to small businesses and support for the government's efforts to gather and disseminate economic and demographic data. CBO estimates that outlays for function 370 will total about $3 billion in 2003, with virtually all of that spending mandatory. (Spikes in mandatory and later in discretionary spending reflect funding for the decennial census, and the large negative amounts for mandatory spending in the mid-1990s reflect proceeds from the resolution of failed banks and thrifts.)

Federal Spending, Fiscal Years 1990-2003 (In billions of dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Estimate 2003
Budget Authority (Discretionary)	3.9	2.8	3.4	2.5	1.4	3.1	2.2	1.4	0.4	0.8	5.1	1.4	0.6	*
Outlays														
Discretionary	3.8	3.4	2.6	2.1	0.9	2.9	1.7	1.6	0.5	0.5	4.5	1.5	1.0	*
Mandatory	63.8	72.9	8.3	-24.0	-5.1	-20.7	-12.1	-16.2	0.5	2.2	-1.3	4.4	-1.4	3.1
Total	67.6	76.3	10.9	-21.9	-4.2	-17.8	-10.5	-14.6	1.0	2.6	3.2	5.9	-0.4	3.1
Memorandum: Annual Percentage Change in Discretionary Outlays	n.a.	-12.6	-21.7	-19.9	-59.4	234.1	-41.3	-3.9	-69.4	-8.3	892.0	-67.1	-32.2	-95.1

Note: * = between zero and $50 million; n.a. = not applicable.

370-01—Discretionary

End the Credit Subsidy for the Small Business Administration's Major Business Loan Guarantee Programs

(Millions of dollars)	2004	2005	2006	2007	2008	Total 2004-2008	Total 2004-2013
Savings							
Budget authority	73	75	76	78	80	382	807
Outlays	38	70	72	74	76	330	735

The Small Business Administration (SBA) operates several loan guarantee programs to increase small businesses' access to capital and credit. Under the Federal Credit Reform Act of 1990, the credit subsidy for those programs is the estimated net present-value cost (over the lives of the loans) of projected defaults minus fees and recoveries, excluding administrative costs. The SBA's largest business credit programs are the general business loan guarantee, or 7(a), program; the certified development company, or 504, program; and the small business investment company (SBIC) equity capital programs. Both the certified development company and SBIC loan programs operate without a federal subsidy. Reducing to zero the subsidy for all of the SBA's other major business loan guarantee programs would lower outlays by $38 million in 2004 and $330 million over the 2004-2008 period.

Under the 7(a) program, the SBA's largest loan program, the federal government can guarantee 85 percent of the principal for business loans up to $150,000 and 75 percent of the principal for larger loans. Small business investment companies in the SBIC program (private investment firms licensed by the SBA) make equity investments and long-term loans to small firms, using their own capital supplemented by SBA-guaranteed debentures.

In 1996, the Congress amended both the Small Business Act and the Small Business Investment Act to reduce subsidy rates and improve the performance of the SBA's business loan programs. One change the Congress made was to increase the fees paid by loan recipients for most business loans. Such fee increases help to reduce program costs because the revenues from the fees cover some of the expenses if a borrower defaults. In 2001, the Congress decreased the fees to their current levels, which are determined by the amount of the loan guarantee. For loans of $150,000 or less, the guarantee fee is 1 percent of the guaranteed portion. For those loans, lenders are permitted to retain 25 percent of the fee. For loans between $150,000 and $700,000, the SBA charges a 2.5 percent guarantee fee. For loans greater than $700,000, it charges a guarantee fee of 3.5 percent.

Since 1996, the Congress has cut the percentage of each loan amount that the government guarantees under the 7(a) program from about 90 percent to the current level of about 75 percent. Reducing the guarantee rates further should induce banks to evaluate loan applications more carefully because the banks will share more responsibility for any losses from defaults. If banks used more care in approving SBA loans, the default rate would decline and the costs to the government decrease accordingly. Adjusting fees (and changing loan guarantee levels) to cover potential default losses could make the SBA's major business loan programs financially sound. As the subsidy rate declined to zero, the Congress would no longer have to appropriate funds to cover the government's expected losses.

Supporters of this option contend that subsidies are not necessary to encourage the private sector to make financing available to small businesses. They also argue that the SBA's assistance serves only a tiny fraction of the nation's small businesses and that most of the programs' borrowers could obtain financing without the SBA's help.

Opponents of this option believe that the SBA's assistance aids small businesses by filling a gap in financing when banks and other private sources do not provide loans for the purposes, in the amounts, or with the terms required by small-business borrowers. Some opponents also argue against increasing program fees or decreasing guarantee rates because such changes would reduce access to credit for small businesses.

370-02—Discretionary

Eliminate the International Trade Administration's Trade Promotion Activities or Charge the Beneficiaries

(Millions of dollars)	2004	2005	2006	2007	2008	Total 2004-2008	Total 2004-2013
Savings							
Budget authority	217	279	288	297	306	1,387	3,076
Outlays	163	244	278	294	303	1,282	2,953

The International Trade Administration (ITA) of the Department of Commerce runs a trade development program (which assesses the competitiveness of U.S. industries and promotes exports) and the U.S. and foreign commercial services (which counsel U.S. businesses on exporting). The ITA charges some fees for its services, but those fees do not cover the cost of all such activities.

This option would eliminate the ITA's trade promotion activities or charge the beneficiaries. Those changes would save $163 million in outlays in 2004 and $1.3 billion through 2008.

Proponents of this option argue that trade promotion activities are better left to the firms and industries that stand to benefit from them than to the ITA. Opponents might argue that those activities are subject to some economies of scale; if so, having one entity (the federal government) counsel exporters on foreign legal and other requirements, disseminate knowledge of foreign markets, and promote U.S. products abroad might make sense. In that case, net federal spending could be reduced by charging the beneficiaries of those programs their full costs.

Proponents also note that when beneficiaries do not pay the full costs of services, the ITA's activities effectively subsidize the industries involved. Those implicit subsidies are an inefficient means of helping the industries because they are partially passed on to foreigners in the form of lower prices for U.S. exports. Moreover, they result in the industries' products being sold abroad for less than their cost of production and sales and thus lower U.S. economic well-being.

Opponents of this option counter that fully funding the ITA's trade promotion activities through voluntary charges might not be possible. For example, in many cases, promoting the products of selected firms that were willing to pay for such promotion would be impossible without also encouraging demand for the products of other firms in the same industry. In those circumstances, firms would have an incentive not to purchase the services because they would be likely to receive the benefits whether they paid for them or not. Consequently, if the federal government wanted to charge beneficiaries for the ITA's services, it might have to require that all firms in an industry (or the industry's national trade group) decide together whether to purchase the services. If the firms opted to purchase them, all firms in the industry would be required to pay according to some equitable formula.

RELATED OPTIONS: 150-01, 350-01, and 350-02

RELATED CBO PUBLICATIONS: *Causes and Consequences of the Trade Deficit: An Overview*, March 2000, and *How the GATT Affects U.S. Antidumping and Countervailing-Duty Policy*, September 1994

370-03—Discretionary

Eliminate the Advanced Technology Program

(Millions of dollars)	2004	2005	2006	2007	2008	Total 2004-2008	Total 2004-2013
Savings							
Budget authority	150	192	196	201	206	945	2,052
Outlays	24	83	151	183	197	638	1,705

The Omnibus Trade and Competitiveness Act of 1988 established the Advanced Technology Program (ATP) within the Commerce Department's National Institute of Standards and Technology. The objective of the ATP is to further the competitiveness of U.S. industry by helping convert discoveries in basic research more quickly into technological advances with commercial potential. The program awards research and development (R&D) grants on the basis of merit to individual companies, independent research institutes, and joint ventures. The ATP's grants are limited to $2 million over a three-year period when awarded to a single firm and require, on average, a matching commitment from private sources. The grants support research in generic technologies that have applications for a broad range of products as well as research that precedes product development. Eliminating the ATP would save $24 million in outlays in 2004 and $638 million over the 2004-2008 period.

The Administration and other supporters of this option argue that private investors are better able than the federal government to decide which research efforts should be funded. They argue that even when the federal government chooses "a winner," it may be displacing private capital. The U.S. venture capital markets are the best developed in the world, supporters say, do an effective job of funding new ideas, and focus on many of the same research areas as the ATP. Furthermore, venture capital funds have grown enormously since the ATP was conceived. In the first three quarters of 2002, venture capital funds invested $16.9 billion, about 65 times the size of the ATP. In addition, according to industry sources, venture capital firms had another $90 billion in reserves committed to them but not yet invested. That size differential suggests that the ATP is funding work that would have been funded by venture capital firms.

Responding to the criticism that the Advanced Technology Program is merely displacing private and venture capital funds, opponents of this option point to a 2001 survey showing that 63 percent of the firms that applied for but did not win an ATP award did not proceed with R&D. Another 17 percent proceeded but on a much smaller scale. Only 5 percent of firms denied ATP funds went ahead with their R&D programs as originally designed. Opponents of this option argue that the survey shows that the ATP's selection process has been refined so as to reduce the overlap between projects that the ATP is likely to fund and those that private sources are likely to finance, even if the general research areas are similar. (That result is a change from an earlier survey by the General Accounting Office, which found that fully half of nonwinners were able to find private sources of funding.) Furthermore, this option's opponents argue, venture capital firms spend only a small fraction of their funds on the very early stages of technology development—the area in which the ATP concentrates its funding.

Critics of this option also note that surveys of the ATP's award recipients indicate that the awards have accelerated the development and commercialization of advanced technology by two years or more in the majority of planned commercial applications. In addition, those surveys show that recipients are more willing to tackle high-risk technology development projects as a result of their grants, presumably increasing both the amount and the breadth of the R&D funded.

RELATED OPTION: 370-04

370-04—Discretionary

Eliminate the Manufacturing Extension Partnership and the National Quality Program

(Millions of dollars)	2004	2005	2006	2007	2008	Total 2004-2008	Total 2004-2013
Savings							
Budget authority	91	116	119	123	126	575	1,250
Outlays	17	66	98	115	122	418	1,073

The Manufacturing Extension Partnership (MEP) and the National Quality Program are run by the National Institute of Standards and Technology. MEP consists primarily of a network of manufacturing extension centers that assist small and midsize firms by providing expertise in the latest management practices and manufacturing techniques as well as other knowledge. The nonprofit centers are not owned by the federal government but are partly funded by it. The National Quality Program consists mainly of the Malcolm Baldrige National Quality Award, which is given to firms for achievements in quality. This option would eliminate MEP and the National Quality Program, reducing outlays by $17 million in 2004 and $418 million through 2008.

Supporters of this option could question the need for the government to provide the technical assistance given by MEP. Many professors of business, science, and engineering are also consultants to private industry, and other ties between universities and private firms facilitate the transfer of knowledge. In fact, some of the centers that MEP subsidizes predate the program.

Advocates of eliminating MEP also could question the program's positive effect on productivity. Federal spending for MEP represents a subsidy for the firms that the program helps. In most cases, subsidies allow inefficient firms to remain in business, tying up capital, labor, and other resources that would otherwise be used more productively elsewhere. For 2004, the Administration proposes eliminating the federal contribution to all centers with more than six years' experience—a substantial total reduction—in line with what it argues is the original design of the program.

Opponents of this option point to the economic importance of small and midsize firms, which produce more than half of U.S. output and employ two-thirds of U.S. manufacturing workers. Small firms, they argue, often face limited budgets, a lack of expertise, and other barriers to obtaining the information that MEP provides. Those circumstances and the substantial reliance of larger firms on small and midsize companies for supplies and intermediate goods lead opponents of this option to argue that MEP promotes U.S. productivity and international competitiveness.

In regard to the National Quality Program, proponents of this option could argue that businesses need no government incentives to maintain quality—the threat of lost sales is sufficient. Furthermore, winners of the Baldrige Award often mention it in their advertising, which means they value it. If so, supporters of this option say, they should be willing to pay contest entry fees large enough to eliminate the need for federal funding. Critics of this option counter that the National Quality Program promotes U.S. competitiveness.

RELATED OPTION: 370-03

370-05—Mandatory Offsetting Receipts

Charge All Banks and Thrifts Deposit Insurance Premiums

(Millions of dollars)	2004	2005	2006	2007	2008	Total 2004-2008	Total 2004-2013
Added Receipts	1,400	1,600	900	500	400	4,800	6,600

Federal deposit insurance protects accounts up to $100,000 in the event of a bank's failure, and the Federal Deposit Insurance Corporation Improvement Act of 1991 authorized the Federal Deposit Insurance Corporation (FDIC) to levy risk-based premiums on banks to cover the cost of that insurance. However, the Deposit Insurance Fund Act of 1996 limited the FDIC's ability to charge those premiums. Currently, deposit insurance premiums are assessed on about 10 percent of all banks and thrift institutions; the remainder pay nothing for deposit insurance even though they pose some risk of loss for the government.

This option would apply to banks and thrifts the FDIC's rate schedule for banks that was in effect before 1996; as a result, the vast majority of institutions that do not pay deposit insurance premiums now would pay a premium of 4 basis points (4 cents per $100 of deposits) per year. (The FDIC's current schedule of insurance premiums ranges from zero to 27 basis points.) That change would increase receipts to the government by $1.4 billion in 2004 and $4.8 billion over five years.

The Deposit Insurance Fund Act stipulated that when the accumulated reserves of a deposit insurance fund exceed 1.25 percent of insured deposits, the FDIC is prohibited from charging premiums of all but the riskiest institutions. The risk classification of a bank or thrift is based on the amount of capital it holds, the quality of its assets, the effectiveness of its management, and other factors. When insurance fund reserves fall below 1.25 percent of insured deposits, the FDIC must raise rates sufficiently to increase the reserve ratio to 1.25 within a year. The Congressional Budget Office projects that, under current law, the accumulated reserves in the Bank Insurance Fund may fall below the 1.25 percent target balance in 2003, largely because of growing deposits in banks that currently pay no premiums.

Proponents of this option argue that there are several rationales for charging all banks and thrifts some deposit insurance premium even when insurance funds' reserves exceed 1.25 percent of insured deposits. First, that target level of reserves bears no relation to expected losses. Second, even institutions in the best risk category pose some risk of failure over time and consequently should pay some premium, just as private insurers impose some premium on even the best risks. Third, recent experience indicates that some failures occur abruptly from risks that cannot be easily quantified or tracked, such as fraud or losses by rogue traders.

A disadvantage of this option is that the 4-basis-point premium, which would be paid by most institutions, is only a crude approximation of the risks they pose. Some institutions would be charged too much and some too little. Ideally, a more accurate risk-based system of premiums, including some charge to the least risky institutions, could be reinstated.

Opponents of this option contend that the current level of reserves provides ample protection to taxpayers. They argue that a strengthened regulatory regime and better risk-management practices make a repeat of the bank and thrift crisis of the 1980s highly unlikely. In addition, banks and thrifts may pass the cost of deposit insurance on to borrowers and depositors. To the extent that depositors undervalue FDIC insurance, banks might be put at a competitive disadvantage in attracting deposits compared with uninsured substitutes such as money market mutual funds.

RELATED CBO PUBLICATION: *Raising Federal Deposit Insurance Coverage*, May 2002